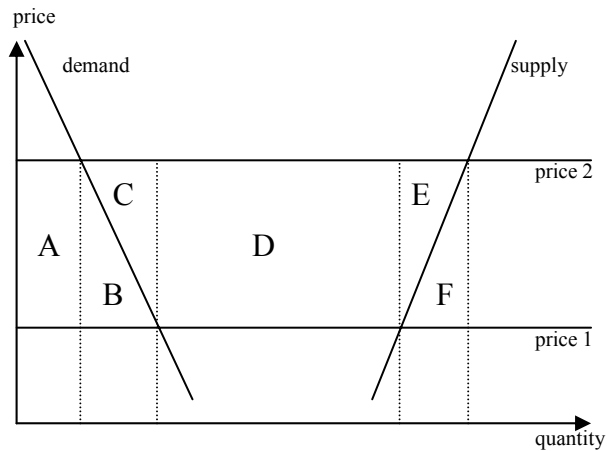


7. Use partial equilibrium analysis to examine the difference between a production subsidy and an export subsidy for a small open economy. Assume the subsidy amount per unit is the same in both cases. Explain the differences in terms of producer and consumer surplus changes, the change in government expenditures, and deadweight loss.



Using the diagram above a production subsidy would mean all producers receive price 2, and all consumers would pay the world price, price 1. The gain in producer surplus would be  $+(ABCDE)$ . The government would pay a subsidy of  $-(ABCDEF)$  and the deadweight loss would be  $-F$

An export subsidy would give price 2 only to goods that were exported, goods consumed domestically would receive no subsidy. The gain in producer surplus would be  $+(DE)$  and the cost to the government would be  $-(DEF)$  with the same deadweight loss of  $-F$ .

8. True, False or Uncertain. Explain. “In terms welfare (i.e. changes in consumer & producer surplus, etc.) it makes no difference whether a tax is imposed upon consumers or producers of a good.”

**False.** While this may be true in a closed economy case, it is not so in an open economy. For example, imagine a country that does not produce a good, but imports and consumes it. A tax on producers would have no welfare effects, while a tax on consumers would lower consumer surplus and result in a deadweight loss.

More generally, if the tax is imposed on consumers it will distort the consumption decision and not the production decision. Since these two amounts do not need to be the same with trade, the effects of a consumption tax may differ from the effects of a production tax.

Section II – Essay (15 pts. each)

5. Discuss the relation between the Edgeworth-Bowley Box and the Production Possibilities Frontier. Discuss what these would look like if both goods were produced using identical homothetic technologies that also exhibit increasing returns-to-scale.

**(5 pts) The Edgeworth-Bowley Box shows the isoquants for production of two goods with origins on opposing corners. The dimensions of the box are given by the economy's total endowments of the two factors. An efficiency locus shows all points in the box where it is impossible to produce more of one good without reducing the production of the other good. These points will have isoquants for the two goods touching in tangency. Moving along the efficiency locus and plotting the amounts of the two goods produced at each point against each other gives the PPF.**

**(10 pts) If both goods have identical homothetic preferences then the efficiency locus is a straight diagonal line between the two origins. This must be that case because identical and homothetic preferences implies that both goods will have the same capital to labor ratios regardless of how much of each is produced. Moving along the efficiency locus, then become an exercise in changing the scale without changing the capital to labor ratio. Since we assume increasing returns-to-scale, this means the PPF must bow inward.**

6. List three pieces of legislation passed in the US since 1929, which have had significant effects on trade. Explain the major features of each and the approximate date they became law.

**(5 pts each)**

**1930 Smoot-Hawley Tariffs – increased average tariff rate by 53%**

**1934 Reciprocal Trade Agreement Act – allowed the president to negotiate in a multilateral framework on an item-by-item basis to reduce tariffs.**

**1962 Trade Act – allowed the president to negotiate on an across-the-board basis, led to the Kennedy Round of GATT negotiations.**

**1984 Trade Act – allowed the president to negotiate in a bilateral framework, led to free trade agreements with Israel, Canada, Mexico, etc.**

**may be other important acts that should count for full credit**

**Brigham Young University Department of Economics**  
**Economics 458 - International Trade**  
**Dr. Phillips (section 1) Fall Semester 2003**

**Final Exam key**  
**Dec. 15th, 2003**

This exam is closed book and closed notes, though you may use a calculator. Read all questions carefully before answering. Write your answers legibly in the space provided. Keep your answers concise and correct. Points will be deducted for answers which are irrelevant to the question.

Section I – Short Answer (10 pts. each)

1. OECD countries are relatively capital abundant, the rest of the world is relatively labor abundant. Manufactured goods are relatively capital intensive and raw materials are relatively labor intensive. What patterns of trade would you predict for OECD and non-OECD countries based upon a Heckscher-Ohlin model?

**OCED will export manufactured goods and import raw materials**  
**Non-OECD will export raw materials and import manufactured goods**

2. For the most part, the technology and factor endowment differences between the US and Canada are trivial. What patterns of trade would you predict for the US and Canada, based upon an increasing returns-to-scale model of trade?

**There are gains from trade due to the ability to exploit economies of scale. However, the trade patterns are not predictable and may be determined by historic accident or chance. There may be significant amounts of intra-industry trade.**

3. Briefly describe a political-economic model where freer trade is not realized, despite the fact that more people benefit from free trade than are harmed.

**If everyone votes their self-interest, but there is a significant cost to participation in the political process, then freer trade which gives diffuse benefits to large numbers of voters while imposing high costs on a few, may not be implemented even though the total social benefit exceeds the total social cost. If the winners do not gain enough to justify participating in the decision process, only the potential losers will have a voice.**

4. Give a brief history of GATT. When was it established? When did it cease to exist? What were its major accomplishments and when did they occur?

**GATT was created as part of the Bretton-Woods agreement in 1945. It's main purpose was to facilitate the lowering of tariffs world-wide through multilateral negotiations. The main achievements were the Kennedy and later rounds, where negotiation was done on an across-the-board basis, rather than item-by-item. The final round of negotiations (Uruguay round) ended in 1994 with an agreement to replace GATT with a permanent body known as the WTO.**